United States General Accounting Office

GAO

By the Comptroller General of the United States

March 2002

HIGHLIGHTS OF GAO'S CORPORATE GOVERNANCE, TRANSPARENCY AND ACCOUNTABILITY FORUM

GAO

Accountability ★ Integrity ★ Reliability

GAO-02-494SP

Report Documentation Page

Report Date	Report Type	Dates Covered (from... to)
00MAR2002	N/A	-

Title and Subtitle HIGHLIGHTS OF GAO S CORPORATE GOVERNANCE, TRANSPARENCY AND ACCOUNTABILITY FORUMs	**Contract Number**
	Grant Number
	Program Element Number
Author(s)	**Project Number**
	Task Number
	Work Unit Number
Performing Organization Name(s) and Address(es) U.S.General Accounting Office P.O.Box 37050 Washington,D.C.20013	**Performing Organization Report Number** GAO-02-494sp
Sponsoring/Monitoring Agency Name(s) and Address(es)	**Sponsor/Monitor's Acronym(s)**
	Sponsor/Monitor's Report Number(s)

Distribution/Availability Statement
Approved for public release, distribution unlimited

Supplementary Notes

Abstract
The recent sudden and largely unexpected bankruptcy of one of the nation s major corporations,Enron Corporation,and the financial difficulties being experienced by several other large corporations have resulted in substantial losses to employees and shareholders.Many believe that the decline of Enron and other instances of financial statement earnings restatements and bankruptcies have resulted in a general decline in investor confidence in our financial markets and in certain key parties under our current system,such as external auditors.These events have also raised a range of questions regarding how such dramatic and unexpected dealings can happen under our current system and the role of various key players under that system.As a result, a number of congressional committees and executive branch agencies have initiated Enron related investigations.

Subject Terms

Report Classification unclassified	**Classification of this page** unclassified
Classification of Abstract unclassified	**Limitation of Abstract** SAR

Number of Pages
15

Comptroller General
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United States General Accounting Office
Washington, DC 20548

March 5, 2002

Subject: Highlights of GAO's Corporate Governance, Transparency, and Accountability Forum

The recent sudden and largely unexpected bankruptcy of one of the nation's major corporations, Enron Corporation, and the financial difficulties being experienced by several other large corporations have resulted in substantial losses to employees and shareholders. Many believe that the decline of Enron and other instances of financial statement earnings restatements and bankruptcies have resulted in a general decline in investor confidence in our financial markets and in certain key parties under our current system, such as external auditors. These events have also raised a range of questions regarding how such dramatic and unexpected dealings can happen under our current system and the role of various key players under that system. As a result, a number of congressional committees and executive branch agencies have initiated Enron related investigations.

The Congress has asked GAO to examine many of the systemic issues arising from its oversight in connection with these matters. In particular, the Congress and GAO are interested in changes that could serve to reduce the possibility of other Enron-like situations occurring in the future. To provide us with a foundation to help inform this work, on February 25, 2002, we convened a forum on corporate governance, transparency, and accountability. Forum participants included individuals from federal and state government, the private sector, standards setting and oversight bodies, and a variety of other interested parties.

The forum was designed to discuss systemic issues, including accounting and reporting, corporate governance, auditing, pensions, oversight, and other selected matters. As expected, the forum participants expressed a range of views on these broad topics, which do not necessarily represent GAO's views. However, there was general agreement that there are no simple solutions, or a single "silver bullet," and that the Congress needs to be careful not to act on perceived problems without appropriate review and analysis. To do otherwise may result in actions with unintended consequences. Several other key observations follow.

- Potential investors and shareholders would benefit from financial information that is more timely and understandable, including reporting of key trends, performance indicators, and risk-related information.

- Accounting and reporting rules should be based on "economic substance" of the related transactions and should employ a "substance over form" doctrine in resolving related matters. Auditors should place additional emphasis on whether the financial statements "fairly present the financial condition" of the entire entity in all material respects rather than merely assuring that the financial statements are presented "in accordance with generally acceptable accounting principles." Auditors should also assure that the financial statements are not "materially misleading."

- Management is primarily responsible for a firm's financial condition and related financial reporting. Those in key corporate leadership positions, as well as external auditors, must set the tone for managing ethically and with integrity.

- Audit committees have an important role to play in overseeing and interacting with internal and external auditors.

- External auditors should view shareholders as their clients versus management, and they must maintain independence and stand firm in resolving key financial reporting and audit issues. In this regard, external auditors play an important safety net role to protect the shareholders, the public, and others.

- Because defined contribution plans that provide participant-directed investments have experienced significant growth, more emphasis needs to be placed on providing additional education and appropriate advice to plan participants.

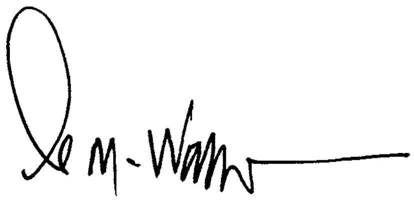
- Consideration should be given to providing greater parity between senior management and other employees, including 401(k) plan participants, in connection with the ability to sell stock or other equity instruments.

- Steps need to be taken to strengthen enforcement of existing requirements and to hold the responsible parties fully accountable for any related problems. This should involve both civil and criminal sanctions, as appropriate.

- Additional safeguards, more effective oversight, and tighter enforcement by regulators and others will not necessarily prevent businesses from failing. However, greater attention to these issues is necessary to help ensure that investors adequately understand related risks, financial performance is measured in an accurate and timely manner, and conflicts of interest are identified and properly dealt with.

Appendix I includes further highlights of the matters discussed by the forum's participants, who are listed in appendix II. Prior to the forum, we provided them with possible questions for discussion, which are shown in appendix III. We anticipate that the forum members will meet in the future to again share knowledge and provide current perspectives on these issues, which are of great concern to the financial well-being of the nation and its citizens. This document will be posted to our website at www.gao.gov.

I wish to thank each of the forum participants for providing their insights on the important matters this document discusses. I appreciate their willingness to spend their time and to provide their views in connection with various matters concerning corporate governance, transparency, accountability, and other issues.



David M. Walker
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GAO's Corporate Governance, Transparency, and Accountability Forum

Highlights of the Forum Discussion

The forum's overall objective was to have an informal and interactive discussion regarding certain systemic challenges, such as those associated with the recent decline of Enron. Some have questioned how an entity such as Enron could fall so quickly and unexpectedly. Many believe that the decline of Enron and other instances of financial statement earnings restatements and bankruptcies have resulted in a general decline in investor confidence in our financial markets and in certain key parties under our current system, such as external auditors. While the focus of the forum was not on Enron per se, it serves to illustrate a number of the systemic and interrelated challenges that need to be addressed.

Addressing these challenges will involve the public, private, and not-for-profit sectors. In general, there must be the proper incentives, transparency, and accountability mechanisms in place to ensure the effectiveness of any system. As a result, these principles were considered in connection with all of the issues discussed.

Accounting and Financial Reporting

The forum participants identified the following as important issues to be addressed in designing an updated accounting and financial reporting model.

- Accounting and reporting rules should be based on "economic substance" of the related transactions and should employ a "substance over form" doctrine in resolving related matters.

- There are trade-offs between principles-based and rules-based accounting standards. Principles-based standards should focus on substance over form and may result in volatility and inconsistent implementation among entities. Rules-based standards, however, can be too detailed and compliance oriented and focus more on form over substance. They can also lead to attempts by key parties to ask "show me why I can't do this?" Both approaches require that all key parties have integrity and exercise good judgment.

- International accounting standards are moving toward a more principles-based approach. Ultimately, we may see more of a convergence between international and United States accounting standards.

- It may be feasible to have more rigorous reporting requirements for larger entities, particularly those that pose a greater individual risk to capital markets, investors, and others. Investors, though, should be clear on any differing requirements.

- It is often difficult for investors and other users, even experts, to understand the complexities of current financial reporting, including for example, disclosures on derivatives and special purpose entities. Steps should be taken to help assure that investors have the ability to comprehend and inquire about any issues with significant implications on value or risk. It will be a challenge to define the degree of required understandability, given the wide disparity of expertise among investors.

- There has been a proliferation of pro forma financial statements, which allows “spin” in reporting financial results and causes confusion for investors and others in understanding a corporation’s true financial picture and prospects.

- There is a fair amount of interest in more useful and timelier reporting, perhaps on a quarterly or even more frequent basis. However, such reporting will require even greater communication to explain the swings in financial results and may require accounting standards setters to evaluate current provisions for leveling or “smoothing” financial results over multiple periods.

- There is need for more timely, useful, and consistent information about important trends and key performance indicators. This type of information needs to be considered in connection with any broader reporting model.

Auditing

Forum participants identified the following key issues related to auditing.

- Auditors should view shareholders as their clients versus management. The board of directors and the audit committee serve as agents for the shareholders and have a fiduciary responsibility to them.

- Auditors should place additional emphasis on whether the financial statements “fairly present the financial condition” of the entire entity in all material respects rather than merely assuring that the financial statements are presented “in accordance with generally acceptable accounting principles.” Auditors should also assure that the financial statements are not “materially misleading.”

- Auditors need to stress their independence over any other business relationships or potential conflicts of interest with their clients. They should emphasize with management the need for making the right disclosures rather than ascertaining whether the rules do not preclude management-preferred forms of disclosure.

- Consideration might be given to strengthening independence by looking at periodic audit firm rotation, renewable terms, or periodic rotation of all key personnel assigned to an audit within a firm. Rotation, though, is costly in terms of an extended start-up time due to lost experience, particularly for larger entities with complex finances.

- Consideration might also be given to adopting a variety of auditing models, such as more joint auditing, instead of a “one firm does all” approach. For example, Canada requires big banks to have two auditing firms.

Pensions and Savings Plans

Forum participants identified the following key issues related to employee pension and savings plans.

- The advent of 401(k) plans and a decrease in defined benefit plans have caused employees, rather than employers, to bear related investment risks.

- The average plan participant does not have sufficient amounts in their 401(k) plans to retire at ages such as 55 years.

- Plan participants are not required to diversify their portfolios and may too narrowly concentrate their portfolios on a single stock of interest to them, such as their employer. For this and other reasons, the investing public may not necessarily want a paternalistic approach from government on investment options and choices. However, they may need more flexibility to reallocate employer matching contributions from stock to other forms of investment in a more timely manner than required under current law.

- Many employees may also want to share in the growth and success of an entity they work for, and employers may want to use stock and/or stock options to ensure or increase company loyalty and better align employee interests with those of the company and other shareholders. There are many successful examples of entities with employee stock ownership and stock option plans. There are also examples of when such plans were not successful.

- A large segment of the investing public, including 401(k) plan participants, may not have all the knowledge necessary to make intelligent investment decisions, and may want or need additional education and appropriate investment advice. For example, they need additional assistance to better understand the need for diversification and the risks associated with building large percentages of their account in any one investment, especially employer securities.

- Consideration should be given to requiring more transparency and parity in the rights of senior management vis-à-vis plan participants, particularly as to the rights to sell company stock during plan freezes or lockdown periods.

Corporate Governance

Forum participants identified the following key issues related to corporate governance.

- The United States is largely viewed as having the most effective capital markets in the world, and the current system of corporate governance has generally supported these markets and the overall economy of the United States over the past several decades.

- It is not readily clear whether the spate of recent business failures and earning restatements, such as Enron, is a result of systemic weaknesses in the current corporate governance structure. Any major revisions to corporate governance models should be considered only after obtaining and analyzing as much information as possible from past failures and restatements.

- A governmental body, or unit, modeled perhaps after the National Transportation Safety Board, and whose sole purpose would be to investigate large business failures, could lead to more immediate results and help to prevent such failures in the future. This body, or unit, would need to draw upon expertise from a variety of governmental and nongovernmental entities in discharging its mission.

- Management is primarily responsible for the accuracy and integrity of an entity's financial reporting, internal controls, performance reporting, and compliance with applicable laws and regulations, as well as for establishing and enforcing an appropriate code of conduct.

- The integrity and competency of top management, often referred to as the "tone at the top," are critical factors in an entity's ultimate success. The nominations and compensation committees of boards of directors can play a meaningful role in ensuring that entities identify and attract competent and ethical members of the board and senior management–the right people in the right environment--and ensuring fair and transparent compensation policies.

- Boards of directors, including audit committees, work for the shareholders and should have appropriate job qualifications, independence, and resources to be able to do their job effectively.

- Consideration needs to be given to matters such as (1) what type of relationship the board should have with management (for example, constructive engagement), and (2) what, if any, selection process changes are necessary in order to assure the proper identification of qualified and independent board members.

- The mutual funds industry might be a good model for defining the expertise needed for audit committee membership, as well as for nominations and compensation committees.

- Increasing demands regarding expertise and potential liability concerns could limit the number of potential committee candidates. However, there is a vast pool of more senior, former corporate executives and public accounting profession members that could serve as potential committee members (e.g., early retirees).

- Audit committees are not in a position to manage the audit process and, thus, may not be in the best position to hire the auditors. However, audit committees can serve as a buffer between the external auditors and company management, which hires the auditors.

- Audit committees would be most effective if they (1) are comprised of highly qualified individuals who are truly independent of top management, (2) meet periodically (e.g., quarterly) with both external and internal auditors without entity management present, and (3) have their own counsel and other resources. Audit committees need to ensure that there is an effective internal audit function, effective internal controls, and an appropriate code of conduct, and they need to invest time in researching the entity and asking the right questions.

- Consideration might be given to creating more independent, whistle-blowing mechanisms within entities, such as establishing chief ethics officers or ombudsmen. It may make sense to model such a mechanism in part on the current federal inspector general concept. Here again, there is a large pool of highly qualified early retirees who could fill such positions.

Oversight

Forum participants identified the following key issues related to oversight.

- Capital markets and investors rely on entities to report timely and reliable financial information and to provide reasonable disclosure to understand related risks.

- Effective oversight will not necessarily prevent entities from making bad business decisions and from failing. Oversight can, however, help to ensure that investors adequately understand related risks; that financial performance is measured in a timely, accurate, and reasonably consistent manner; and that conflicts of interest are identified and properly dealt with.

- A more direct government role in accounting and auditing standards setting and other intervention may not necessarily improve oversight, particularly when taking into account the knowledge and expertise needed to address conflicts of interest and increasingly complex financial issues. It may be more effective in the long run for regulators to require stronger self-regulatory measures, to aggressively oversee those measures, and to take more timely and meaningful civil and criminal enforcement actions when rules are violated.

- Many entities today are taking a closer look at their own governance and risks in light of recent high profile business failures. Disclosure of how they address key governance issues, in the form of asking questions or adopting best practices, may be more effective than placing undue reliance on severe enforcement mechanisms, such as delisting companies.

- There may be merit in considering more rigorous requirements and/or restrictions for larger companies, such as those listed on the major exchanges. In such instances, though, investors should know fully about any differing requirements.

Where Do We Go From Here

The forum participants identified the following ideas for possible follow-up.

- Efforts by GAO and other organizations to identify possible common denominators for major business failures might identify other specific issues, particularly those related to potential conflicts of interest and inadequate disclosures.

- Best practices guides in connection with certain important areas (e.g., audit committees) could be beneficial in helping to enhance the effectiveness of the related parties.

- Roundtable discussions with members of specific groups, such as audit committee members or internal auditors, might help to identify other specific issues related to corporate governance, transparency, and accountability.

- The issues identified in this forum should be periodically revisited by these participants or by others. For example, this group should consider meeting again in one year to review and assess progress and determine what, if any, additional actions may be appropriate.

GAO's Corporate Governance, Transparency, and Accountability Forum

Participants

Charles A. Bowsher	Chair, Public Oversight Board; and Former Comptroller General of the United States
William E. Brock	Former Secretary, U.S. Department of Labor
Robert C. Butler	Former Chair, Financial Accounting Standards Advisory Council
James G. Castellano	Chair, American Institute of Certified Public Accountants
James Cochrane	Senior Vice President, Strategy and Planning, New York Stock Exchange
Michael J. Cook	Retired Chairman and Chief Executive Officer Deloitte & Touche LLP
Mark W. Everson	Controller, Office of Management and Budget
Kayla J. Gillan	General Counsel, CalPERS
Christina Gold	Vice Chair, The Conference Board
Barbara Hafer	President, National Association of State Auditors, Comptrollers, and Treasurers
Robert K. Herdman	Chief Accountant, Securities and Exchange Commission
Edmund L. Jenkins	Chair, Financial Accounting Standards Board
Marc Lackritz	President, Securities Industry Association
Philip B. Livingston	President, Financial Executives International
Barry C. Melancon	President, American Institute of Certified Public Accountants
Robert A. G. Monks	Founder, Institutional Shareholder Services; and Former Assistant Secretary, Pension and Welfare Benefits Administration, U.S. Department of Labor

David Mosso	Chair, Financial Accounting Standards Advisory Board
John F. Olson	Chair, ABA Committee on Corporate Governance
Stephen C. Patrick	CFO, The Colgate-Palmolive Company
Gary J. Previts	Chair, Global Communications Committee of the International Association of the Financial Executives Institute
Roger W. Raber	President, National Association of Corporate Directors
David S. Ruder	Former Chair, Securities and Exchange Commission
Mary L. Schapiro	President, NASD Regulation; and Former Chair, CFTC
David Shedlarz	Executive Vice President and CFO, Pfizer Inc.
A.W. Pete Smith	President and CEO, Private Sector Council
Stanley Sporkin	Former Director of Enforcement, SEC; and Former Federal District Court Judge
Elmer B. Staats	Former Comptroller General of the United States
Mark J. Ugoretz	President, ERISA Industry Committee

GAO's Corporate Governance, Transparency, and Accountability Forum

Possible Questions for Discussion

GENERAL:

- What steps need to be taken to minimize the possibility that another rapid and unexpected decline and fall of a major public company and related pension plans, like the Enron situation, will occur?
- What types of systemic issues need to be reviewed and considered (e.g., accounting/reporting, auditing, corporate governance, pensions, self-regulatory, legislative, regulatory, enforcement)?

ACCOUNTING/REPORTING:

- Do the current accounting/reporting and SEC disclosure models provide meaningful, timely and useful information for investors and other key stakeholders to make informed decisions?
- Are there significant items of value that the current accounting and reporting model does not adequately address?
- Are there significant liabilities, commitments, contingencies or other risk related items that the current accounting and reporting model does not adequately address (e.g., special purpose entities, uncovered arbitrage positions)?
- Is there a need for enhanced key trend or projection information in corporate financial statements?
- What should be the minimum standards for "pro-forma" financial information reported by public companies?
- How does the Internet (e.g., company web site information) affect the current accounting and reporting model?

AUDITING:

- Are there significant items of value or risk that the current audit model does not adequately address?
- Does the current approach to testing and reporting on internal controls make sense?
- Does the current audit framework relating to fraud make sense?
- What type of relationship should the outside auditor have with management?
- What type of relationship should the outside auditor have with the Board and the Audit Committee?
- Are the current disciplinary mechanisms in place for auditors adequate and effective?
- What, if any, changes need to be made to the current peer review model?
- What, if any, changes in the current auditor independence rules should be made?
- How does the Internet (e.g., company web site information) affect the current audit model?

CORPORATE GOVERNANCE:

- Should CEO's also serve as Chairman of the Board in public companies?
- Who should select Board candidates for voting on by the shareholders?
- What, if any, minimum qualification requirements should be imposed on public company board and audit committee members?
- Should there be additional restrictions on the number of inside directors for public companies?
- What, if any, changes should be made to the role and structure of audit committees (e.g., revisions to independence definitions, limitations on compensation levels/methods and/or rotation of members)?
- How can the Board and the outside auditors work together to enhance shareholder value and better address shareholder risks, including the overall control environment?

PENSIONS:

- What, if any, additional restrictions should be considered or additional guidance is needed in connection with plan investments in employer securities? How might these vary by type of plan (e.g., 401(k) plans versus ESOPs)?
- What, if any, modifications in regulatory or enforcement approaches should be considered in connection with plan investments in employer securities?
- What, if any, changes should be considered in connection with plan freezes of investment elections due to changes in plan service providers (e.g., plan recordkeeper)?

OVERSIGHT:

- What is your reaction to Chairman Pitt's proposal of new oversight bodies for the accounting profession?
- What, if any, changes need to be made in the current review and oversight models to identify possible cases like Enron before they occur in addition to conducting post-mortems?
- How can the coordinated and integration of the current multi-faceted and multi-dimensional oversight model be improved?
- Does the POB have adequate authority and resources to effectively discharge its audit oversight responsibilities?
- Does the SEC have adequate authority and resources to effectively discharge its reporting, regulatory and enforcement responsibilities?
- Does the DOL have adequate authority and resources to effectively discharge its pension oversight responsibilities?
- Does the AICPA have adequate authority and resources to effectively discharge all of its professional governance responsibilities (e.g., standards, monitoring, disciplinary actions)?

OTHER:

- What, if any, changes should be made in connection with conflict of interest rules for corporate management?
- What, if any, revisions or restrictions should be made in connection with insider trading?
- What, if any, changes are necessary in connection with the role and function of securities analysts?
- What, if any, other related systemic issues should be discussed?

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